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IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. .....

CONTRACTING PLUMBERS COOPERATIVE RESTORATION CORPORATION,

Petitioner,

—v.—

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Contracting Plumbers Cooperative Restoration Corporation petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit in this case.

Opinions Below

The opinion of the United States District Court for the Eastern District of New York (Appendix A, *infra,* pp. 1a-9a) is not officially reported, but may be found at 72-2 U.S.T.C. ¶ 9371 and 30 A.F.T.R.2d 72-5780. The opinion of the court of appeals (Appendix B, *infra,* pp. 10a-18a) is reported at 488 F.2d 684.

Jurisdiction

The judgment of the court of appeals (Appendix C, *infra*, pp. 19a-20a) was entered on December 13, 1973. A timely petition for rehearing filed by petitioner was denied by the court of appeals by order dated January 23, 1974. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

Question Presented

Whether petitioner, a nonprofit corporation formed to take over from the City of New York the task of ensuring the efficient permanent repair of excavations made in the streets of New York City by petitioner's members in the course of their plumbing activities, is exempt from federal income tax as a social welfare organization under section 501(c)(4) of the Internal Revenue Code, or as a business league under section 501(c)(6) of the Code.

Statute and Regulations Involved

The statute and regulations involved in the case are sections 501(a), 501(c)(4), and 501(c)(6) of the Internal Revenue Code of 1954 and sections 1.501(c)(4)-1(a) and 1.501(c)(6)-1 of the Treasury Regulations on Income Tax. These provisions are set forth in Appendix D, *infra*, pp. 21a-23a.

Statement

Petitioner was formed in January 1968 under the New York Cooperative Corporations Law as a nonprofit membership corporation with membership open, without charge, to all master plumbers licensed in New York City.

Petitioner was formed to take over a municipal function of the City of New York and to meet a pressing community need. Prior to 1968, whenever it was necessary for a plumber to make an excavation (sometimes referred to as a "plumber's cut") in the streets of New York City, the plumber was required to obtain a permit from the City of New York. After completing the work, the plumber was required to fill in the excavation and repair the street with a temporary patch. He would then notify the City of New York, which had the responsibility to make permanent repairs to the street and which made such repairs through its employees. The plumber was required to pay to the City a specified amount for the permanent restoration of the cut. This procedure, however, proved disadvantageous to all parties involved: New York City, its citizens, and the plumbers. First, the City took an average of eight to ten months to restore the plumbers' cuts, resulting in prolonged dangerous conditions and disruption of traffic, as well as numerous complaints to, and threatened lawsuits against, the City and the plumbers. Second, the City, in performing the permanent restoration work, was spending approximately $2 million a year more than the amounts it charged the plumbers.

As a result of this unsatisfactory situation, the City and the plumbers had discussions as to how to remedy the prob-

lem. These discussions led to the formation of petitioner, with the City's approval, to take over from the City the task of supervising and arranging for the restoration of plumbers' cuts.[1] The performance of this task has been petitioner's sole activity since its inception. Petitioner has charged the plumbers approximately the same amount for restoration as had been charged by the City. After this function was taken over by petitioner, the time for restoring a cut was reduced from an average of eight to ten months to an average of fourteen working days, thereby substantially reducing the prolonged dangerous and disruptive conditions that existed when the City alone had been responsible for permanent restoration. In addition, the City was relieved of an annual two million dollar deficit.

Petitioner reported and paid income taxes on its 1968 taxable income[2] and subsequently filed a claim for refund with the Internal Revenue Service on the ground that it was an organization exempt from federal income tax. Upon denial of the refund claim, petitioner initiated a refund suit in the United States District Court for the Eastern District of New York. The district court sustained the petitioner's contention that it was both an organization organized and operated exclusively for the promotion of social welfare under section 501(c)(4) of the Internal Revenue Code,[3] and a business league under section 501(c)(6) of the Code.

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[1] The letter from the Commissioner of the New York City Highway Department approving the formation of petitioner stated: "It is expected that joint cooperation on this undertaking will be of mutual benefit to the City of New York and the plumbing industry."

[2] In 1968, petitioner's income exceeded expenses by $5,239.

[3] Hereinafter, references to sections are to sections of the Internal Revenue Code of 1954, unless otherwise specified.

The government appealed to the United States Court of Appeals for the Second Circuit, which reversed the district court.

Reasons for Granting the Writ

1. *Summary.* The reasons for granting petitioner's writ may be summarized as follows:

a. The decision of the Second Circuit Court of Appeals on petitioner's section 501(c)(4) status as a social welfare organization is in direct conflict with the decision of the Ninth Circuit Court of Appeals in *Monterey Public Parking Corp.* v. *United States,* 481 F.2d 175 (9th Cir. 1973), *aff'g,* 321 F. Supp. 972 (N.D. Cal. 1970), as well as with other court decisions and with published rulings of the Internal Revenue Service.

b. The decision of the Second Circuit on petitioner's section 501(c)(6) status as a business league is in direct conflict with several long-standing courts of appeals decisions (*e.g., Crooks* v. *Kansas City Hay Dealers' Association,* 37 F.2d 83 (8th Cir. 1929)), as well as with the published position of the Internal Revenue Service.

c. The court of appeals below based its decision on a finding, wholly unsupported by the record and flatly contrary to the findings of the district court, that petitioner's individual members benefited directly from its activities through substantial monetary savings.

d. The decision of the court below places unwarranted restrictions on the extent to which private persons or entities may establish a tax exempt organiza-

tion to perform a function normally carried on by a governmental unit under circumstances where the interests of the government, the general public, and the private organizers coincide. In a time when the burdens of government are increasing at a rapid pace, and when private persons or businesses are often willing to relieve such burdens, the decision of the court below discourages the formation of organizations to relieve burdens of government and promote the public interest.

2. *Petitioner's claim for exemption as a social welfare organization under section 501(c)(4).* Section 501(c)(4) of the Code grants exemption from federal income tax to "civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare." Both parties are agreed that petitioner is not organized for profit; the issue presented is whether petitioner was "operated exclusively for the promotion of social welfare." Treasury Regulations section 1.501(c)(4)-1(a)(2)(i), the validity of which is not here in question, makes it clear that "operated exclusively" means, for this purpose, "operated primarily," and neither party disputes this construction of the statute.

Nor is there any question that arranging for the efficient repair of holes in city streets represents "bringing about civic betterments and social improvements" within the meaning of the Regulations, and hence the "promotion of social welfare" within the meaning of the statute. Unfilled street excavations obviously represent a danger and inconvenience to the public, and the common good and general welfare of the public are served by arranging for the prompt restoration of city streets to safe conditions. Moreover, by taking on this activity (which was the responsibility

of New York City), by performing the activity more efficiently, and by relieving the City of a two million dollar annual deficit, petitioner assumed (with the concurrence of the City of New York) a burden of government, which is well recognized as a method of promoting social welfare. Since petitioner's sole activity was to arrange for the prompt repair of city streets, a "social welfare" activity, and since petitioner was not operated for profit, it would appear that the requirements of section 501(c)(4) were satisfied.

The court of appeals below, however, denied exemption on the ground that petitioner's activities benefited its members in some impermissible fashion. In reaching this conclusion, the court brought itself into direct conflict with a recent decision of the Ninth Circuit Court of Appeals, as well as with numerous rulings by the Internal Revenue Service. In *Monterey Public Parking Corp.* v. *United States*, 481 F.2d 175 (9th Cir. 1973), *aff'g*, 321 F. Supp. 972 (N.D. Cal. 1970), the Ninth Circuit Court considered a situation quite analogous to that here involved. *Monterey* dealt with a nonprofit corporation formed to construct and operate a public parking facility, which charged parking fees, in the central business district of Monterey, California. After discussion with city authorities, the corporation was formed by several private businesses and professional persons (all but one of whom had business establishments located near the parking facility) because it was felt that the municipal government could not expeditiously finance and construct the parking facilities needed to revitalize the city's central business district.

The taxpayer's claim for exemption under both sections 501(c)(3) and 501(c)(4) was sustained by the district court and the Ninth Circuit. The organizers of the taxpayer

in *Monterey* undeniably benefited from the construction and operation of parking facilities near their businesses, but the district court found that such benefit did not defeat the exemption claim since it was "indistinguishable" from the benefits to the community as a whole. 321 F. Supp. at 976.

The same is true in the instant case to an even greater degree. The public was endangered and inconvenienced by the delay on the part of New York City in repairing city streets, and precisely this effect on the public had a detrimental effect on the plumbing industry and its members, who in the minds of the public were seen as responsible for the problem. Consequently, the benefit to the public from prompt repairs necessarily benefited petitioner's members, whose interests were identical to the interests of the public. As discussed below, petitioner's members realized no cost savings from petitioner's activities. In this respect, the benefit to the organizers in *Monterey,* who obtained the benefit of parking facilities near their businesses which had not previously existed, was much more direct than in this case, where petitioner simply assumed a pre-existing governmental function with no direct benefits to individual members.

The court below attempted to distinguish *Monterey,* but could do so only by making new findings of fact which were not contained in the opinion of the district court and which were without foundation in the trial record. The court below concluded that, by forming petitioner, the plumbers of New York effected a substantial saving in the amounts paid for the restoration of the plumbers' cuts, and that petitioner's members enjoyed economic benefits "precisely" to the extent they used and paid for petitioner's restoration services.

The record in this case provides no support for these findings by the Second Circuit Court. The formation of petitioner did not affect in any significant way the amount the plumbers were required to pay for the restoration of plumbers' cuts. The City charged the plumbers for restoring plumbers' cuts, but did not recover its full costs through such charges and wound up operating at an annual deficit of $2 million. The court below makes the wholly unwarranted assumption that this $2 million deficit "almost inevitably" and "almost certainly" would have been passed on to the plumbers had the municipal system of restoration continued. App. B, pp. 14a, 15a. There is no evidence in the record that the City was contemplating an increase in its charges to the plumbers. Neither is there any evidence that a reduction in charges to the plumbers was a factor in the formation or operation of petitioner. Moreover, the minimum amounts, including permit and inspection fees, charged to petitioner's members for street restoration by the City of New York and by the petitioner at the time of petitioner's formation were $75.50 and $85.00, respectively, so that in fact petitioner's members had their minimum costs increased. Finally, it should be noted that the issue of costs to the plumbers is illusory since whatever cost is involved is passed on in full to the customer.

Stripping away the wholly unsupported finding of the Second Circuit Court that the plumbers saved themselves some $2 million annually, the benefits to petitioner's members from petitioner's activities consisted of a reduction in complaints against the members and the industry, a better image for the plumbing industry generally, and a reduction in potential liability, all brought about by the speedier restoration work accomplished by petitioner.

These benefits, of course, are part and parcel of the benefits received by the public: reduced inconvenience, accidents and injuries. As found by the trier of fact, the district court below, "the benefit received by the plumbers is indistinguishable from the benefit to the community as a whole, *i.e.*, the substantial reduction in injuries and lawsuits." App. A, p. 5a. It follows, therefore, that petitioner's members in no sense enjoyed economic benefits "precisely" to the extent they paid for petitioner's services, for any reduction in potential liability and any increased goodwill were not related to specific payments made by petitioner's members, but rather inured in a general and unquantifiable way to all plumbers whose cuts were restored through petitioner.

Taking the facts as compelled by the record and as found by the district court, the legal question becomes: where an organization performs only one activity and where such activity provides a general benefit both to the public and to an industry, and if the benefit to the public furthers an exempt purpose, does the organization forfeit its claim to exemption because of the indistinguishable general benefit to private parties?

The Second Circuit Court's answer to this question is in square conflict with the decision of the Ninth Circuit Court in *Monterey*. The courts in *Monterey* took the view that, if an organization provides benefits to private and public interests which are "indistinguishable," the organization is operating primarily for exempt purposes. The court of appeals below, however, concentrated solely on the benefits to petitioner's members, without considering the impact of the district court's finding that the public and private benefits from petitioner's activities were "indistinguishable."

Most other authorities under section 501(c)(4), including rulings of the Internal Revenue Service, have adopted the approach of the *Monterey* case as opposed to that of the court below in this case. For example, in Revenue Ruling 72-102, 1972-1 Cum. Bull. 149, the Internal Revenue Service ruled exempt under section 501(c)(4) a membership organization formed by a real estate developer to preserve the architecture and appearance of a housing development and to maintain common areas, streets and sidewalks for the use of all residents of the development, all of whom were required to become members of the organization. The ruling found that through its activities the organization was "serving the common good and the general welfare of the people of the entire development." 1972-1 Cum. Bull. at 149-50. The ruling went on to state that, even though the organization was established by the developer and may have aided him in selling houses, any benefits to him were "merely incidental." *Id.* at 150. Similarly, the ruling concluded that, even though the organization's activities served to preserve and protect property values in the community, such benefits to the property owner-members were also merely incidental to the organization's purpose of promoting the common good of the community.[4] *Id.*

[4] In Revenue Ruling 74-99, 1974-9 Int. Rev. Bull. 11, the Internal Revenue Service clarified Revenue Ruling 72-102 by providing that there would be a prima facie presumption that organizations formed by developers for the preservation and maintenance of a development are "essentially and primarily" formed and operated for the individual business or personal benefit of their members and thus do not qualify for exemption under section 501(c)(4). Organizations, however, may overcome this presumption. It is interesting to note that Revenue Ruling 74-99 gives as an example of a public purpose the maintenance of areas such as roadways, parklands, sidewalks and street lights which are used by the general public, as opposed to the private purpose of maintaining areas where access is restricted to members of the organization.

The Second Circuit Court's construction of the concept "operated primarily" within the meaning of the Regulations under section 501(c)(4) tends to defeat the purpose of the statute to encourage the formation of social welfare organizations. The court's holding would deny tax exemption to any organization formed to carry out social welfare purposes so long as the creators or members of the organization derive some benefit from the very same operations that benefit the public. Tax exemption would be denied where private and public interests are the same, clearly an undesirable principle in a social and economic system whose ultimate success is premised on the hope that private and public interests will coincide without the necessity of extensive governmental regulation. The Ninth Circuit in *Monterey* and the district court below in this case took the proper view: where an activity promotes the general welfare of the public, it is no bar to exemption that the activity produces a benefit to private parties which is indistinguishable from the benefit to the public.

3. *Petitioner's claim for exemption as a business league under section 501(c)(6).* Section 501(c)(6) grants exemption from federal income tax to "business leagues . . . not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual." As noted above, the parties are in agreement that petitioner is not organized for profit. Similarly, there is agreement that no part of petitioner's net earnings may inure to the benefit of any private individual.[5] The ques-

[5] Under petitioner's organizational documents, its earnings may be distributed "only to such tax exempt organizations which have been formed for the purpose of and engage in promoting the plumbing industry in the City of New York."

tion is thus whether petitioner is a "business league" within the meaning of the statute.

The applicable Treasury Regulations, whose validity is not in question, provide that a business league is "an association of persons having some common business interest, the purpose of which is to promote such common interest . . . ." Regs. sec. 1.501(c)(6)-1. The Regulations also provide that the activities of a business league "should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons." *Id.*

The district court below found that petitioner was a business league within the meaning of the Regulations because its activities promoted "the public interests of the member master plumbers by efficiently restoring plumbers' cuts in New York City and thereby lessen[ed] complaints and claims by pedestrians and motorists as well as homeowners," and did not represent the performance of particular services for individual persons. App. A, pp. 8a-9a. In reversing, the court of appeals below found, erroneously, that petitioner was engaged in providing particular services for individual persons, but, as in the case of its holding on the application of section 501(c)(4), this holding was based on findings of fact not made by the district court and unsupported by the record.[6]

[6] The court of appeals, as noted above, found that petitioner's members received individual benefits "precisely" proportional to their financial involvement in the organization. This conclusion was based on the erroneous conclusion, discussed above, that through the efforts of petitioner its members were able to effect a substantial reduction in the amounts they paid for restoring plumbers' cuts. The record contains no indication whatever that the reduction of costs to the plumbers was a motive in the formation of petitioner, and in fact petitioner's operations have resulted in no such reduction of restoration costs to the plumbers.

More importantly, the court of appeals below ignored the fact that the "services" provided by petitioner to its members were not services which its members could have purchased, or would have had to purchase, from some other source, but instead represented the performance of a municipal function that was the responsibility of the City of New York. In this sense, petitioner did not provide services for its members at all, for petitioner did not take on responsibilities that were those of the plumbers, but rather took on responsibilities that were those of the City of New York. For example, the plumbers had the direct responsibility for the temporary restoration of plumbers' cuts. Had petitioner taken over this function from the plumbers, it could then be said with justification that petitioner was providing particular services for its members. However, petitioner did not take over such a function, but instead stepped into the shoes of the City of New York. To the extent petitioner was providing particular services, such services were provided to the City of New York, and not to its members.

The benefit derived by petitioner's members from petitioner's activities, then, was not the performance of particular services and, as discussed above, was not a reduction in the cost to members of restoration, but instead was a general benefit derived from the prompt and efficient repair of plumbers' cuts. From such prompt and efficient restoration, the plumbing industry generally benefited from a reduction of complaints, bad publicity, and potential liability and lawsuits. To the extent that individual members shared in this benefit, such benefit was only "incidental" to the general benefit to the plumbing industry, and it is well established that this type of "incidental" benefit does not defeat exemption under section 501(c)(6).

The rationale for this principle is clear. Obviously the members of a business league expect some benefit from the activities of the organization, and, if the organization promotes a line of business, the members in turn derive a benefit in their individual businesses from the broader benefit to the line of business as a whole. Consequently, both the courts and the Internal Revenue Service have uniformly held that, if a particular activity promotes a line of business and at the same time "incidentally" benefits particular members, such an activity does not defeat exemption. The guiding principle was aptly put by the Tax Court in *National Leather & Shoe Finders Association,* 9 T.C. 121, 126 (1947), a decision in which the Internal Revenue Service acquiesced:

> ". . . it can hardly be supposed that individuals would often join organizations without the expectation of receiving some personal benefits therefrom. In recognition of this, the courts have held that if the individual benefits, such as particular services rendered to members, are only incidental or subordinate to the main or principal purposes required by the statute, exemption is not to be denied the organization."

The narrow position of the court of appeals in this case is in square conflict with the numerous decisions which have adopted a broader, more sensible view.

Thus, one of the earliest cases in the area, *Crooks* v. *Kansas City Hay Dealers' Association,* 37 F.2d 83 (8th Cir. 1929), involved an organization of hay brokers which employed individuals to inspect, weigh and watch railroad cars of hay bought or sold by members and charged shippers for this service. The court held the organization to be an exempt business league, saying:

> ". . . It is an association that is helpful undoubtedly to the members individually, but which is likewise an aid to commerce, and conduces to the general welfare by establishing an honest market for the buying and selling of hay and straw and by assisting in preserving its integrity." 37 F.2d at 85.

The court also found that the receipt of proceeds from services to members was "merely incidental" to the organization's exempt purposes. 37 F.2d at 86. On similar facts, the court in *Little Rock Grain Exchange* v. *Thompson,* 93 F. Supp. 571 (E.D. Ark. 1950), sustained exemption, noting that the taxpayer's inspection activities also created goodwill for the industry and stimulated business in the community.

The taxpayer in *American Plywood Association* v. *United States,* 267 F. Supp. 830 (W.D. Wash. 1967), provided industry-wide quality control services which clearly benefited at the same time the industry, its members, and the public. The court found the taxpayer exempt, analyzing the situation as one in which "the individual and personal benefits enjoyed by members . . . are inherently and most immediately group benefits." 267 F. Supp. at 835. Similarly, in this case, the benefits from petitioner's activities were "group benefits." The increase in goodwill for the plumbing industry was clearly a group benefit, and the same is true of the benefit of reduced exposure to potential liability and lawsuits. Like the benefit of improved quality control, the value to a particular plumber of such reduced exposure cannot be precisely measured, but is a benefit inuring generally to the industry as a whole.

Numerous published rulings by the Internal Revenue Service support petitioner's claim for exemption under sec-

tion 501(c)(6). To take but one of the most pertinent, Revenue Ruling 67-394, 1967-2 Cum. Bull. 201, held exempt an organization of small loan companies formed in response to state banking regulations recommending that no borrower become liable to two or more small loan companies for more than a specified sum. The organization maintained files and furnished information on borrowers to its members. The ruling found that the organization enabled its members to cooperate with the state banking department and thereby furthered the common business interests of the line of business "by protecting its membership as a whole from public criticism"; that the organization provided an "important social service for the community" by protecting borrowers from becoming indebted beyond their capability to pay, thereby improving conditions in the line of business; and that any benefits to individual members from receiving information on borrowers were "merely incidental" to the principal purpose of the organization. Exactly the same conclusion is required in the instant case.

The holding of the court of appeals below on section 501(c)(6) exemption discourages, without any justification, activities of business leagues which benefit the public, the line of business involved, and, incidentally, the members of the industry. Moreover, the Second Circuit position represents a complete departure from well-settled principles concerning the impact on section 501(c)(6) exemption of activities benefiting an industry generally and benefiting industry members incidentally.

Conclusion

For the reasons stated, the petition for a writ of certiorari should be granted.

Respectfully submitted,

MITCHELL ROGOVIN
RICHARD L. HUBBARD
Attorneys for Petitioner
1229 19th Street, N.W.
Washington, D.C. 20036

Of Counsel:

ROBERT N. COOPERMAN
880 Third Avenue
New York, New York 10022

ABRAHAM WILSON
Thirty Broad Street
New York, New York 10004

APPENDICES

APPENDIX A

Memorandum and Order of the United States District Court

[Filed October 31, 1972]

UNITED STATES DISTRICT COURT

EASTERN DISTRICT OF NEW YORK

70-C-1058

CONTRACTING PLUMBERS COOPERATIVE RESTORATION CORP.,

Plaintiff,

v.

UNITED STATES OF AMERICA,

Defendant.

Appearances:

Hon. Robert A. Morse, U.S. Attorney, E.D.N.Y., by William E. Dertinger, Esq., Scott P. Crampton, Esq., Ass't Attorney General, Donald R. Anderson, Esq., Thomas R. Wechter, Esq., attorneys, Department of Justice

Kadel, Wilson, Potts, Esqs., by D. Logan Potts, Esq., Goldman, Cooperman & Levitt, Esqs., by Robert N. Cooperman, Esq., 122 East 42nd Street, New York, New York 10017

COSTANTINO, D.J.

This is a timely commenced action brought by plaintiff, Contracting Plumbers Cooperative Restoration Corp., against the United States of America for a refund of the income taxes paid by it for its first fiscal year, the period ending December 31, 1968, in the sum of $928.72, with interest. At the outset the court determines that it has sufficient jurisdiction over this action pursuant to 28 U.S.C. §§ 1346(a)(1), 1340 (1971).

After a review of the trial minutes, the evidence and post-trial memoranda of law, this court is convinced that plaintiff should recover the taxes in question as it qualifies as a tax exempt organization under sections 501(c)(4) and 501(c)(6) of the Internal Revenue Code of 1954.

Plaintiff was incorporated on January 11, 1968 pursuant to Article 2 of the New York Cooperative Corporations Law. Section 13 of the Cooperative Corporations Law provides that cooperative corporations incorporated thereunder may not be conducted for profit. Article 2, section 1 of plaintiff's By-Laws states:

> The purposes for which the Corporation is formed are to operate and maintain within the City of New York and in coordination with the Department of Highways and/or other applicable agencies of the City of New York a program or programs for rendering mutual help and service to the Corporation's members by arranging for the repaving or replacement of streets, curbs and sidewalks required to be repaved or replaced by the members of the Corporation, and to engage in all lawful activities and powers relating to the implementation of the aforesaid program or programs as are authorized under the provisions of Article 2 of the Cooperative Corporations Law.

Further reference to the cooperative's By-Laws indicates that all master plumbers licensed in New York City are eligible for membership in the cooperative. (Certificate of Incorporation, paragraph 3, By-Laws, Article 3, Section 1). At present approximately 98% of all licensed master plumbers belong to the cooperative and any income, assets or surplus may not be distributed to individual members but rather exclusively to tax-exempt organizations promoting the plumbing industry in New York City. (By-Laws, article 11).

The testimony of Stanley L. Gold, former Department Commissioner for the Bureau of Operations, Department of Highways shed further light on the nature of the plumbers' cooperative. He testified that between 1964 and 1968, as a representative of the City of New York, he was engaged in negotiations with the various plumbers' associations concerning the creation of plaintiff cooperative. His testimony reveals that prior to the creation of the cooperative in January of 1968 the City was directly responsible for the restoration of plumbers' cuts. Although the plumbers paid the City $22.50 per square yard to restore the plumbers' cuts, this amount did not adequately compensate the City, as the actual cost of restoration was much higher. Consequently, the restoration and the actual cost of the restoration to the City was passed on to the taxpayer. In addition, Mr. Gold's survey of 1965 indicated that only 60% of plumbers' cuts were being restored in the same year because of more pressing obligations on the Department of Highways limited manpower and equipment. The Commissioner further testified that the inefficiency of the city run operation had caused many traffic problems as well as subjecting the City to numerous law suits. He concluded by saluting plaintiff for its average restoration

time of 14 work days, as opposed to the average eight or ten month restoration time in pre-cooperative days and pointed out the benefit afforded the City in reduced accidents and the consequent reduction in lawsuits against the City.

Mr. Whalen, Executive Vice President of the cooperative, testified that the cooperative was organized to relieve the plumbing industry and the community in general from the adverse effects resulting from the inefficient restoration of plumbers' cuts. He further testified that the cooperative engaged in no other activity other than the restoration of plumbers' cuts.

Given the aforementioned facts, the court first finds that plaintiff qualifies for tax exempt status pursuant to § 501 (c)(4), "... Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare."

The Treasury Regulations on Income Tax (1954 Code) indicates the following:

> § 1.501(c)(4)-1 Civic organizations and local associations of employees.
>
> (a) *Civic organizations* (1) *In general.* A league or organization may be exempt as an organization described in section 501(c)(4) if—(i) It is not organized or operated for profit; and (ii) It is operated exclusively for the promotion of social welfare.
>
> (2) *Promotion of social welfare. In general.* An organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization embraced within this section is one which is oper-

> ated primarily for the purpose of bringing about civic betterment and social improvements. . . .

The court makes reference to plaintiff's Certificate of Incorporation as well as testimony at trial which characterizes the cooperative as a non-profit organization. The court also feels that the primary purpose of the cooperative was to promote the social welfare of the people of the community. The court finds that all New Yorkers benefited from the efficient recovering of plumbers' cuts whether they be homeowners, motorists or pedestrians. In addition the court finds that the cooperative is performing a public function which heretofore was performed by the Department of Highways, whose function was certainly to promote the public welfare. In addition, the court finds that the benefit received by the plumbers is indistinguishable from the benefit to the community as a whole, *i.e.*, the substantial reduction in injuries and lawsuits.

In so holding, the court relies on the case of *Monterey Public Parking Corporation* v. *United States*, 321 F.Supp. 972 (W.D. Cal. 1970), in which a nonprofit California corporation organized by hometown businessmen for the purpose of operating a parking facility qualified for exemption pursuant to § 501(c)(4). That court used the following reasoning:

> This Court cannot say that plaintiff corporation, organizationally or operationally, subserves, in any substantial way, private interests. There is no question that all but one of plaintiff's organizers were businessmen whose establishments would tend to suffer if the traffic problems of downtown Monterey were not soon resolved. But this was a threat not only to plaintiffs, but to all the City of Monterey. . . .

> The City of Monterey, therefore, was the primary beneficiary when plaintiff succeeded in constructing public parking facilities without any significant outlay of public funds. . . . The provision of public parking can clearly be regarded as a burden of local government, and when this is accomplished by private individuals, this burden is lessened within the meaning of Regulation § 1.501(c)(3)-1. It also results in the promotion of social welfare within the intendment of Regulation § 1.501(c)(4)-1.
>
> Plaintiff's organizers were also undeniably benefitted. But this benefit is indistinguishable from that which inhered to the community as a whole. Their profits may have been enhanced or maintained as customers continued to shop in the downtown area, but this observation applies equally to the profits of all downtown businessmen, to the property values of all property owners there, and to the value of the tax base of the entire City of Monterey. The validation stamp system is available to all persons and businesses, not just to the organizers. No profits, direct or indirect, and no advertising advantages have accrued to plaintiff's organizers which have not also accrued to non-organizers. The Court therefore finds that the benefits to plaintiff's organizers do not constitute a substantial non-exempt purpose under either of the subsections of § 501 invoked herein.

Id. at 976.

I also rely on Revenue Ruling 72-102, *Int. Rev.* Bull. No. 10, at 11. There, the Internal Revenue Service held exempt from federal income taxation, pursuant to § 501(c)(4)

> a membership organization that was formed by a developer and [was] operated to administer and enforce covenants for preserving the architecture and appearance of a housing development, and to own and maintain common green areas, streets, and sidewalks for the use of all development residents.

The Internal Revenue Service reasoned that

> By administering and enforcing covenants, and owning and maintaining certain non-residential, non-commercial properties of the type normally owned and maintained by municipal governments, this organization is serving the common good and the general welfare of the people of the entire development. Even though the organization was established by the developer and its existence may have aided him in selling housing units, any benefits to the developer are merely incidental.

In addition, the case presently before this court can be distinguished from two prime decisions of the Second Circuit where tax exemption was denied. Here there are no dividends paid to the members of the cooperative as existed in *Consumer-Farmer Milk Coop.* v. *C.I.R.*, 186 F.2d 68 (2d Cir. 1950), nor is there a substantial surplus of income as existed in *People's Educational Camp Society, Inc.* v. *C.I.R.*, 331 F.2d 923 (2d Cir. 1964).

The court also finds that the plumbers' cooperative is a business league pursuant to Section 501(c)(6) of the Internal Revenue Code of 1954, which affords tax exemptions to

> Business leagues, chambers of commerce, real estate boards, boards of trade, not organized for profit and

no part of the net earnings of which inure to the benefit of any private shareholder or individual.

The Treasury Regulations on Income Tax, Section 1.501 (c)(6)-1 provide for the following:

> A business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. It is an organization of the same general class as a chamber of commerce or board of trade. Thus, its activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons. An organization whose purpose is to engage in a regular business of a kind ordinarily carried on for profit, even though the business is conducted on a cooperative basis or provides only sufficient income to be self-sustaining, is not a business league.

It is the opinion of this court that plaintiff falls within the requirements of the above regulation. Plaintiff is clearly an association of all licensed master plumbers who undeniably have a common business interest. Plaintiff promotes the business interests of the member master plumbers by efficiently restoring plumbers' cuts in New York City and thereby lessens complaints and claims by pedestrians and motorists as well as homeowners.

In addition, plaintiff does not engage in the type of business which is ordinarily carried on for profit. The court minutes reflect the fact that the cooperative has taken over the performance of a municipal function as Chapter 28-A,

§ 692 of the New York City Charter authorizes the Department of Highways to maintain "cognizance and control of the . . . (c) paving, repaving, resurfacing and repairing of all public roads, streets and highways, and of relaying of all pavements removed for any cause." In addition, the court notes that the cooperative also sends inspection report forms to the Department of Highways.

The Government manfully contends that the cooperative is not "directed to the improvement of business conditions of one or more lines of business, as distinguished from the performance of particular services for individual persons" (Treas. Reg. *supra*). It cites the case of *Evanston-North Shore Board of Realtors* v. *United States,* 320 F.2d 375 (Ct. Cl. 1963) for the above proposition. The Evanston case dealt with a real estate multiple listing service which operated like a "stock or commodity exchange. Both are means of bringing buyers and sellers together to facilitate the sale of property." Id. at 380. The plumbers' cooperative is in no way involved in the sale of any service or product to the public. The court therefore feels it need not reach the question as to whether or not fees charged by the cooperative are in approximate proportion to benefits received by the cooperative member.

Plaintiff, Contracting Plumbers Cooperative Restoration Corporation, is therefore exempt from federal income taxation pursuant to 26 U.S.C. § 501(c)(4), (6) (1971).

This opinion is deemed to embody findings of fact and conclusions of law pursuant to Rule 52, Fed.R.Civ.P.

So ordered.

MARK A. COSTANTINO
U. S. D. J.

APPENDIX B

Opinion of the United States Court of Appeals

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

Argued Nov. 12, 1973. Decided Dec. 13, 1973.

Rehearing and Rehearing En Banc
Denied Jan. 23, 1974.

No. 64, Docket 73-1083.

CONTRACTING PLUMBERS COOPERATIVE
RESTORATION CORPORATION,

Plaintiff-Appellee,

v.

UNITED STATES OF AMERICA,

Defendant-Appellant.

Proceedings on appeal from order of the United States District Court for the Eastern District of New York, Mark A. Costantino, J., holding that plaintiff was exempt from federal income taxation as both a civic organization and a business league. The Court of Appeals, J. Joseph Smith, Circuit Judge, held that private, nonprofit cooperative, which was organized by New York City plumbers to effect repairs of "cuts" made in city streets by members in course of plumbing activities, was not entitled to exemption as a civic organization or business league since, among other

things, each member enjoyed economic benefits precisely to extent that he used and paid for restoration services.

Reversed.

Wesley J. Filer, Atty., Tax Div., Dept. of Justice, Washington, D. C. (Scott P. Crampton, Asst. Atty. Gen., Tax Div., Ernest J. Brown and Leonard J. Henzke, Jr., Attys., Tax Div., Dept. of Justice, Washington, D. C., and Robert A. Morse, U. S. Atty., for the Eastern District of New York, of counsel), for defendant-appellant.

Robert N. Cooperman, New York City (Kuh, Goldman, Cooperman & Levitt, New York City, Peter Lushing, of counsel), and Kadel, Wilson & Potts, New York City (Abraham Wilson, New York City, of counsel), for plaintiff-appellee.

Before KAUFMAN, Chief Judge, and SMITH and OAKES, Circuit Judges.

J. JOSEPH SMITH, Circuit Judge:

This is an appeal by the government from a determination by the District Court for the Eastern District of New York, Mark A. Costantino, *Judge*, that taxpayer is exempt as both a "civic organization," 26 U.S.C. § 501(c)(4), and a "business league," 26 U.S.C. § 501(c)(6). While we believe that taxpayer's activities are totally commendable, we nevertheless find that Congress has imposed certain limitations on those two exemptions and that taxpayer simply does not qualify. We therefore reverse.

I.

Taxpayer's sole purpose is to insure the efficient repair of "cuts" made in the streets of New York City by its members in the course of their plumbing activities. Prior to tax-

payer's formation, city employees had repaired such cuts, billing the responsible plumber accordingly. But this municipal restoration program was highly inefficient, subjecting the community to the dangers of—and the plumbers to corresponding liability for—improperly filled excavations for prolonged periods.[1] Moreover, this inefficient program was resulting in an annual operating loss to the city—after reimbursement by the plumbers—of approximately $2 million.

By 1967 this unsatisfactory arrangement had deteriorated to the point that the plumbers were threatening to sue the city to limit their liability, and the city, in turn, was threatening to burden the plumbers with most of the $2 million annual loss. The plumbers therefore proposed that they conduct their own restoration program through a private, non-profit cooperative. The city, undoubtedly overjoyed, agreed with the stipulation that the cooperative make all repairs within thirty days.

In what must surely be a tribute to the private sector, taxpayer has performed more efficiently than even its founders had expected: By promptly assigning the repair work to private contractors and scrupulously monitoring its completion, taxpayer has reduced the average restoration time to approximately fourteen days. Perhaps even more startling, in 1968—the tax year in question—taxpayer not only did not lose $2 million in charging its members the same price the city had been exacting, but actually turned a modest profit of $5239—the taxable income at issue.[2]

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[1] The Deputy Highway Commissioner assigned to the problem testified that the cuts were generally left unrepaired for eight to ten months.

[2] This minimal profit represented slightly more than 1% of the $433,762 that the taxpayer charged its members. Pursuant to taxpayer's by-laws, this profit was distributed to tax-exempt groups promoting the plumbing industry.

II.

Relying on taxpayer's non-profit nature, its public origins, and its undisputed benefit to the people of New York, the district court held that taxpayer was exempt as a "civic . . . organization not organized for profit but operated exclusively for the promotion of social welfare. . . ." 26 U.S.C. § 501(c)(4). The court noted that this statutory definition has been significantly liberalized by regulations providing:

> An organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. [§ 1.501(c)(4)-1(a)(2)]

[1] The district court then found that the taxpayer's value to the community and to its individual members was "indistinguishable," and that therefore the organization was tax-exempt. We cannot agree. Rather we adhere to the rule that the presence of a single substantial non-exempt purpose precludes exempt status regardless of the number or importance of the exempt purposes. People's Educational Camp Society, Inc. v. Commissioner, 331 F.2d 923, 931 (2d Cir.), cert. denied, 379 U.S. 839, 85 S.Ct. 75, 13 L.Ed.2d 45 (1964); American Women Buyers Club, Inc. v. United States, 338 F.2d 526, 528 (2d Cir. 1964). *See also,* Better Business Bureau of Washington, D. C., Inc. v. United States, 326 U.S. 279, 283, 66 S.Ct. 112, 90 L.Ed. 67 (1945); Commissioner v. Lake Forest, Inc., 305 F.2d 814, 820 (4th Cir. 1962).

In applying this standard, we think at least four factors are relevant. First, we must look to the formative history of the organization. Here the plumbers' open disenchant-

ment with both prolonged liability and the threat of increased restoration costs[3] clearly suggests that they had a substantial business interest in taxpayer's formation.

[2] Second, we have the embodiment of that completely legitimate, but nevertheless private, interest in the taxpayer's bylaws:

> The purposes for which the Corporation is formed are to operate and maintain . . . in coordination with the Department of Highways . . . a program . . . for rendering mutual help and service to the Corporation's members by arranging for the repaving or replacement of streets, curbs, and sidewalks required to be repaved or replaced by the members of the Corporation. . . .

While such a statement is not conclusive, Consumer-Farmer Milk Cooperative v. Commissioner, 186 F.2d 68, 70 (2d Cir. 1950), cert. denied, 341 U.S. 931, 71 S.Ct. 803, 95 L.Ed. 1360 (1951), we nevertheless think it is probative as to the taxpayer's non-exempt purpose of mutual aid.

Third, we have the taxpayer's actual operation. Here there can be no doubt that the cooperative is of tremendous value to the private economic interests of its members—a clearly non-exempt purpose. Consumer-Farmer Milk Co-

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[3] The government further contends that many members—notably the smaller operators—have also benefited by the fact that taxpayer reduced the minimum restoration fee from $67.50 (for three cubic yards of fill) to $45.00 (for two yards). Taxpayer strenuously disputes the significance of this reduction.

We find it unnecessary to ascertain the precise extent of these theoretical savings, since they in any event pale before the far more substantial savings occasioned by taxpayer's efficient operation. Most notably, in 1968 taxpayer charged its members $433,672 for repairs that would have cost the city—and almost inevitably the plumbers—an estimated $2.5 million.

operative v. Commissioner, 186 F.2d 68, 71-72 (2d Cir. 1950), cert. denied, 341 U.S. 931, 71 S.Ct. 803, 95 L.Ed. 1360 (1951); Commissioner v. Lake Forest, Inc., 305 F.2d 814, 820 (4th Cir. 1962). The members now have far less liability at a price considerably lower than that which almost certainly would have developed under the former, municipal system. Conversely, it must be remembered that the taxpayer has never followed the "social welfare" into repairing the equally troublesome potholes left by the few remaining nonmember plumbers[4] or the other, more numerous, enterprises that burrow into the city streets.[5]

Finally, we have the fact that each member of the cooperative enjoys these economic benefits *precisely* to the extent that he uses, and pays for, its restoration services. It is this conditional benefit that most distinguishes this case from Monterey Public Parking Corporation v. United States, 321 F.Supp. 972 (N.D.Cal.1970), aff'd, 481 F.2d 175 (9th Cir. 1973)—a district court opinion stressed by both the taxpayer and the court below. In *Monterey* the court held that a private, non-profit parking lot financed by local merchants was exempt under § 501(c)(4)—but only because its organizers had not exploited the facility "by giving themselves special advertising rights, or by restrict-

[4] Not surprisingly, participation by licensed city plumbers has increased from 85% in 1968 to 98% today.

[5] In November of 1972, the city established a color code to indicate responsibility for improperly filled excavations. In addition to the taxpayer, the private subway, telephone and utility companies were required to join the city traffic, water and sewer agencies in so labeling their cuts. N.Y. Times, November 26, 1972 at 84, col. 3. However, enforcement of the code has been difficult (N.Y. Times, February 5, 1973 at 33, col. 1), and the "pothole problem" remains: One city councilman recently complained that the streets of his borough were akin to the "Burma Road." N.Y. Times, May 21, 1973 at 27, col. 7.

ing the validation stamp system to certain businesses. . . . " *Id.* at 975. The court recognized that such limitations would have demonstrated that the merchants "were in fact primarily interested in their own ends rather than those of the public. . . . " *Id.*

Thus, to the extent we might be inclined to agree with *Monterey's* suggestion that "indistinguishable" public and private benefits satisfy the exemption,[6] that theory is inappropriate here where the private benefit to each member is so much more precise.

[3] In sum, we find that the taxpayer provides substantial and different benefits to both the public and its private members, and that we therefore cannot say that it is "primarily" devoted to the common good as required by even the most liberal reading of § 501(c)(4).

III.

Much of the above is relevant to the district court's conclusion that taxpayer is also exempt as a "business league." 26 U.S.C. § 501(c)(6). Here the relevant regulations provide:

> A business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to

---

[6] This dictum in *Monterey* may not have survived the Ninth Circuit's guarded affirmance:

> The District Court made a quantitative comparison of the private versus the public benefits derived from the organization and operation of the plaintiff corporation. Thereby, it was determined that the "social welfare" and "charitable purpose" requirements of the two respective sections were adequately fulfilled. We cannot disagree.

481 F.2d 175, 177 (9th Cir. 1973). We would, of course, agree on such an explicit comparison of distinct public and private purposes.

> engage in a regular business of a kind ordinarily carried on for profit. . . . Thus, its activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons. [§ 1.501(c)(6)-1]

[4] In holding the taxpayer so exempt, the district court again relied on the fact that it is neither organized for profit nor engaged in a traditionally profit-motivated activity. While we agree with these findings, we believe that they only partially satisfy the exemption. Rather we find that taxpayer has failed to prove that its primary purpose is "the improvement of business conditions . . . as distinguished from the performance of particular services for individual persons."

[5] While all plumbers may receive some small, incidental benefit from the goodwill of a community no longer subjected to their improperly filled excavations, each individual member receives far more in economic terms precisely to the extent that he uses the restoration service. In Evanston-North Shore Board of Realtors v. United States, 320 F.2d 375, 378-379, 162 Ct.Cl. 682 (1963), cert. denied, 376 U.S. 931, 84 S.Ct. 700, 11 L.Ed.2d 650 (1964), the court emphasized just such proportional benefit as the most important factor demonstrating that a multiple listing system operated by member realtors was not exempt under § 501(c)(6). The court below attempted to distinguish *Evanston-North Shore* on the grounds that while there the listing service was related to the underlying sale of real estate, here the restoration service involved only the plumbers themselves. We find this unpersuasive. Rather

we believe that the regulations and *Evanston-North Shore* are directed towards a realistic, economic analysis of the benefits derived by the members of the organization. Where, as here, those individual benefits are precisely proportional to the member's financial involvement in the organization, the fundamentally non-exempt purpose of providing a necessary service at reduced cost becomes too clear to be ignored.

Reversed.

APPENDIX C

Order of Reversal

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the thirteenth day of December one thousand nine hundred and seventy-three.

Present:

HON. IRVING R. KAUFMAN,
Chief Judge,

HON. J. JOSEPH SMITH,
HON. JAMES L. OAKES,
Circuit Judges.

73-1083

CONTRACTING PLUMBERS COOPERATIVE RESTORATION CORPORATION,

Plaintiff-Appellee,

v.

UNITED STATES OF AMERICA,

Defendant-Appellant.

Appeal from the United States District Court for the Eastern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Eastern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is reversed in accordance with the opinion of this court with costs to be taxed against the appellee.

A. DANIEL FUSARO
Clerk

by VINCENT A. CARLIN
Chief Deputy Clerk

APPENDIX D

Statute and Regulations Involved

Internal Revenue Code of 1954 (26 U.S.C.):

Sec. 501. Exemption From Tax on Corporations, Certain Trusts, etc.

(a) Exemption From Taxation.—An organization described in subsection (c) or (d) or section 401(a) shall be exempt from taxation under this subtitle unless such exemption is denied under section 502 or 503.

• • • • •

(c) List of Exempt Organizations.—The following organizations are referred to in subsection (a):

• • • • •

(4) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.

• • • • •

(6) Business leagues, chambers of commerce, real-estate boards, boards of trade, or professional football leagues (whether or not administering a pension fund for football players), not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

• • • • •

Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.):

§ 1.501(c)(4)-1. CIVIC ORGANIZATIONS AND LOCAL ASSOCIATIONS OF EMPLOYEES.—(a) *Civic organizations*—(1) *In general.* A civic league or organization may be exempt as an organization described in section 501(c)(4) if:

(i) It is not organized or operated for profit; and

(ii) It is operated exclusively for the promotion of social welfare.

(2) *Promotion of social welfare*—(i) *In general.* An organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvements. A "social welfare" organization will qualify for exemption as a charitable organization if it falls within the definition of "charitable" set forth in paragraph (d)(2) of § 1.501(c)(3)-1 and is not an "action" organization as set forth in paragraph (c)(3) of § 1.501(c)(3)-1.

(ii) *Political or social activities.* The promotion of social welfare does not include direct or indirect participation or intervention in political compaigns on behalf of or in opposition to any candidate for public office. Nor is an organization operated primarily for the promotion of social welfare if its primary activity is operating a social club for the benefit, pleasure, or recreation of its members, or is carrying on a business with the general public in a manner similar to organizations which are operated for profit. See,

however, section 501(c)(6) and § 1.501(c)(6)-1, relating to business leagues and similar organizations. A social welfare organization may qualify under section 501(c)(4) even though it is an "action" organization described in paragraph (c)(3)(ii) or (iv) of § 1.501(c)(3)-1 if it otherwise qualifies under this section.

* * * * *

§ 1.501(c)(6)-1. BUSINESS LEAGUES, CHAMBERS OF COMMERCE, REAL ESTATE BOARDS, AND BOARDS OF TRADE.—A business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. It is an organization of the same general class as a chamber of commerce or board of trade. Thus, its activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons. An organization whose purpose is to engage in a regular business of a kind ordinarily carried on for profit, even though the business is conducted on a cooperative basis or produces only sufficient income to be self-sustaining, is not a business league. An association engaged in furnishing information to prospective investors, to enable them to make sound investments, is not a business league, since its activities do not further any common business interest, even though all of its income is devoted to the purpose stated. A stock or commodity exchange is not a business league, a chamber of commerce, or a board of trade within the meaning of section 501(c)(6) and is not exempt from tax. Organizations otherwise exempt from tax under this section are taxable upon their unrelated business taxable income. See part II (section 511 and following), subchapter F, chapter 1 of the Code, and the regulations thereunder.

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In the Supreme Court of the United States

OCTOBER TERM, 1974

No. 73-1582

CONTRACTING PLUMBERS COOPERATIVE RESTORATION CORPORATION, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the district court (Pet. App. A 1a-9a) is not officially reported. The opinion of the court of appeals (Pet. App. B 10a-18a) is reported at 488 F. 2d 684.

JURISDICTION

The judgment of the court of appeals (Pet. App. C 19a-20a) was entered on December 13, 1973, and a petition for rehearing was denied on January 23, 1974. The petition for a writ of certiorari was filed on April 22, 1974. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether petitioner, an organization of plumbers formed to arrange for the restoration of street excavations made by its members, is exempt from federal tax, either as an organization operated exclusively for the promotion of social welfare under Section 501(c)(4) of the Internal Revenue Code of 1954 or as a business league under Section 501(c)(6) of the Code.

STATUTE AND REGULATIONS INVOLVED

The relevant portions of Section 501(c) of the Internal Revenue Code of 1954 and Treasury Regulations, Sections 1.501(c)(4)-1 and 1.501(c)(6)-1, are set forth at Pet. App. D 21a-23a.

STATEMENT

Petitioner is a non-stock cooperative corporation organized under New York law for the purpose of coordinating the restoration of excavations made by New York City plumbers into city streets and sidewalks. Its membership is open, without charge, to all plumbers who are licensed by the City of New York (Pet. App. A 2a-3a).

Prior to petitioner's formation, the City of New York made all permanent repairs to streets and sidewalks opened by plumbers in connection with the installation and repair of plumbing facilities and billed the responsible plumber for the repairs at a set rate. Such permanent restoration generally took from eight to ten months to perform and resulted in annual operating losses to New York City of approximately $2 million (Pet. App. B 11a-12a). During the period that an excavation remained unrepaired, the plumber's agreement with the city required the plumber to indemnify it for any losses that it might sustain through actions brought by persons injured by the excavation (R. 42-43, 92, 159).[1]

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[1] "R." references are to the joint appendix filed in the court of appeals.

By 1967, the plumbers were so dissatisfied with the municipal restoration program that they threatened to sue the city unless it agreed to reduce substantially the period during which they remained liable for injuries caused by unrepaired streets and sidewalks (Pet. App. B 12a; R. 92, 160). The city, in turn, threatened to raise the repair rates it charged the plumbers for making the restorations in order to recoup the operating losses it had sustained in making the repairs (Pet. App. B 12a; R. 158). The controversy was ultimately resolved by the acceptance of the plumbers' proposal to conduct their own restoration program through a private, non-profit cooperative corporation. Accordingly, in 1968 petitioner was formed and began to coordinate the restoration program (Pet. App. B 12a).

Petitioner's certificate of incorporation and by-laws reflect that its primary purpose is to aid its membership in the restoration of streets and sidewalks damaged by their plumbing activities. Specifically, its certificate of incorporation provides that it "is created primarily for mutual help * * * for the purposes of assisting its members * * * by performing services connected with the purchase and acquisition for its members of labor, supplies and articles of common use" needed in the restoration program (R. 116). Its by-laws provide that the "purposes for which the Corporation is formed are to operate and maintain * * * a program * * * for rendering mutual help and service to the Corporation's members by arranging for the repaving or replacement of streets, curbs and sidewalks required to be repaved or replaced by the members of the Corporation * * *" (R. 123-124; Pet. App. B 14a).

A plumber who wishes to use petitioner's services in making a restoration indicates this fact to an appropriate city official when he obtains a permit to cut into the street or sidewalk. Upon completion of the plumbing

work, petitioner assigns the repair work to a private contractor and reimburses the contractor from funds collected in advance from the plumber. Through this procedure, petitioner has successfully maintained the same repair rates charged by the city prior to 1968, but has reduced the average restoration time to approximately 14 days (Pet. App. B 12a; R. 44-45, 47-50).

During 1968, petitioner realized taxable income of $5,239 from gross receipts of $433,762. Pursuant to petitioner's by-laws, this profit was distributed to various tax-exempt organizations which promote the plumbing industry in New York City (Pet. App. B 12a).

On audit, the Commissioner of Internal Revenue determined that petitioner owed federal income taxes on its income for 1968 because it was not exempt either as an organization operated exclusively for the promotion of social welfare under Section 501(c)(4) of the Code or as a business league under Section 501(c)(6). In a refund suit brought by petitioner, the district court held that it was exempt from federal income taxes under both Section 501(c)(4) and Section 501(c)(6) because of the significant benefits accruing to the residents of New York City through petitioner's restoration program (Pet. App. A 4a-9a.

The court of appeals reversed. It concluded that petitioner was not exempt as an organization operated exclusively for the promotion of social welfare because a substantial objective of both its organization and operation was to provide private economic benefits to its individual members, such as reduced restoration rates and lower liability exposure. The court further held that petitioner was not exempt as a business league, because it was engaged in the performance of particular services directed toward the general improvement of business conditions for the plumbing industry (Pet. App. B 10a-18a).

ARGUMENT

1. Section 501(c)(4) of the Code provides in pertinent part that "organizations not organized for profit but operated exclusively for the promotion of social welfare" are exempt from federal taxes. In defining the meaning of the term "exclusively" as used in a similar provision exempting an organization "operated exclusively for * * * educational purposes" from social security taxes, this Court stated in *Better Business Bureau* v. *United States*, 326 U.S. 279, 283, that "a single noneducational purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly educational purposes." Relying on the "commercial hue" reflected in the organization's charter and its conduct of activities "largely animated by this commercial purpose," the Court held that the organization involved in *Better Business Bureau* was not tax-exempt, despite its "highly commendable" efforts to halt dishonest business practices and educate the business community. *Id.* at 283-284.

As a result, the courts have generally held that an organization cannot qualify for exemption under Section 501(c)(4) if any one of its substantial objectives is nonexempt in character. See *American Women Buyers Club, Inc.* v. *United States*, 338 F. 2d 526, 528 (C.A. 2); *People's Educational Camp Society, Inc.* v. *Commissioner*, 331 F. 2d 923, 931 (C.A. 2), certiorari denied, 379 U.S. 839; see also Treasury Regulations on Income Tax, Section 1.501(c)(4)-1(a)(2)(i). It is well established that the provision of economic benefits to an organization's individual members constitutes such a substantial nonexempt objective. *Commissioner* v. *Lake Forest, Inc.*, 305 F. 2d 814 (C.A. 4); *Consumer-Farmer Milk Coop.* v. *Commissioner*, 186 F. 2d 68 (C.A. 2), certiorari denied, 341 U.S. 931.

Here, the court of appeals correctly held that petitioner had a substantial objective which was incompatible with Section 501(c)(4) status, *i.e.*, to provide economic benefits to its members by maintaining low street repair rates and by reducing its members' exposure to accident liability. In support of its conclusion, the court pointed to four facts which demonstrate beyond question that petitioner's primary purpose was to provide economic benefits to its members. These are: (1) petitioner's formative history which indicated that it was organized because of the plumbers' disenchantment with prolonged liability for unrepaired excavations and because of the city's threats to increase repair costs; (2) the express purpose in the by-laws to operate for the mutual aid of its membership;[2] (3) the actual operation of petitioner which resulted in significant economic benefits to its member-plumbers through reduced liability exposure and maintenance of existing restoration fees; and (4) its members' enjoyment of economic benefits in direct proportion to their use of and payment for petitioner's repair services (Pet. App. B 13a-15a).

Petitioner challenges (Pet. 9) three[3] of the factors relied upon by the court of appeals. It first urges that there is no evidence that maintenance of restoration fees at their former level was a reason for the formation of petitioner. But in so arguing, it overlooks the undisputed evidence that the city was considering raising its fees in 1967 and that petitioner's organization prevented such increases (R. 45, 158; Pet. App. B 12a). Petitioner further

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[2]Petitioner's certificate of incorporation is to the same effect. See p. 3, *supra*.

[3]Petitioner does not dispute the fact that its by-laws show a substantial nonexempt objective, the second factor cited by the decision below.

denied that petitioner's members enjoyed substantial economic benefits in direct proportion to their use of its services by contending that the economic benefits which it provides its members in the form of lower liability exposure and lower costs is merely "part and parcel" of the benefits which it provides the public at large—reduced accidents and lower plumbing charges (Pet. 9-10). But the direct economic benefits enjoyed by petitioner's members were not merely incidental to public advantages derived from petitioner's activities; petitioner's services were provided to each member only to the extent that it paid for them and the services were never performed for nonmembers or nonplumbers (Pet. App. B 15a; R. 63, 80, 85). Thus, while there were collateral benefits accruing to the public from petitioner's operation (as is also true of many business operations), the existence of substantial private benefits to petitioner's members forecloses qualification under Section 501(c)(4), which requires an organization to operate "exclusively for the promotion of social welfare." As the court of appeals stated, "we find that the taxpayer provides substantial and different benefits to both the public and its private members, and that we therefore cannot say that it is 'primarily' devoted to the common good as required by even the most liberal reading of §501 (c)(4)" (Pet. App. B 16a).

2. Contrary to petitioner's contention (Pet. 7-10), the decision below does not conflict with *Monterey Public Parking Corp.* v. *United States*, 481 F. 2d 175 (C.A. 9). There, several private business and professional persons organized a corporation for the purpose of constructing and operating a public off-street parking facility in a downtown area. The court found that all persons using the parking facility paid the same rates, whether they shopped at member businesses or not; that no special privileges, such as advertising rights, were given the members;

and that the parking facility was designed to serve all city residents and businesses. The court concluded that "a quantitative comparison of the private versus the public benefits derived from the organization" demonstrated that the organization did not provide substantial private benefits in any way. *Id.* at 177. Here, however, petitioner's services were limited to members, and, as the court of appeals correctly noted (Pet. App. B 16a), the benefits flowing to petitioner's members were different in character from the benefits which inured to nonmembers and the public.[4]

3. The decision below further held that petitioner was not entitled to tax-exempt status under Section 501(c)(6), as a "business league" "not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual." In order to qualify for exemption under this provision, Section 1.501 (c)(6)-1 of the Treasury Regulations requires that the organization's activities be directed to the "improvement of business conditions of one or more lines of business as distinguished from the performance of particular

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[4]Nothing in Rev. Rul. 72-102, 1972-1 Cum. Bull. 149, as modified by Rev. Rul. 74-99, 1974-9 Int. Rev. Bull. 11, cited by petitioner (Pet. 11), casts doubt upon the correctness of the decision below. The ruling as modified held that an organization composed of members of a housing development formed to preserve its appearance and to maintain streets and common areas was entitled to Section 501(c)(4) status where: (1) the development was large enough to constitute a small community; (2) the organization owned only property open to members of the public, such as roadways, parklands and sidewalks; and (3) the benefits to the members and to the developer who originally established the organization were merely inidental in character. On these facts, wholly distinguisable from the situation here, the ruling concluded that the private benefits accruing to the developer and the members were incidental to the public goal to which the organization's activities were directed, the common good of the community.

services for individual persons."[5] Thus, the critical distinction for purposes of Section 501(c)(6) is whether the business league benefits the business or industry generally, regardless of individual payments or fees, in which case it qualifies for tax exemption, or whether it merely sells services to individual members for a fee, in which case it is not tax exempt. See, *e.g.*, *Indiana Retail Hardware Assn.* v. *United States*, 366 F. 2d 998, 1001 (Ct. Cl.); *United States* v. *Oklahoma City Retailers Assn.*, 331 F. 2d 328, 331 (C.A. 10); *Evanston-North Shore Board of Realtors* v. *United States*, 320 F. 2d 375, 379 (Ct. Cl.), certiorari denied, 376 U.S. 931; *General Contractors' Assn.* v. *United States*, 202 F. 2d 633, 636 (C.A. 7); Rev. Rul. 74-308, 1974-26 Int. Rev. Bull. 12.

Applying this established legal criterion, the court of appeals correctly held that petitioner is primarily engaged in rendering services for its individual members. Each of petitioner's members makes payments to petitioner in exact proportion to the benefits he receives; no payments are made except to the extent that a member requires petitioner's restoration services to repair an excavation caused by his plumbing activities. Petitioner performs no function for the plumbing industry. Rather, it simply coordinates the repair of streets and sidewalks which its member-plumbers have excavated. Even though its activities may indirectly benefit the plumbing trade, its direct benefits are only to those plumbers who pay for petitioner's services—a commercial function which cannot be reconciled with Section 501(c)(6) status.

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[5] This regulation, whose predecessor (Treasury Regulations 74 (1929 ed.), Art. 528) was first adopted in 1929, has repeatedly been held to be a valid interpretation of the statutory language having the force of law. See *e.g.*, *Indiana Retail Hardware Assn.* v. *United States*, 366 F. 2d 998, 999 (Ct. Cl.).

Petitioner does not challenge the test applied by the court of appeals in comparing the benefits it provides to its members with the benefits to the plumbing industry generally. It does, however, attack the conclusion of the court of appeals that the benefits to individual members predominated over the benefits to the industry as a whole. But the precise *quid pro quo* character of the members' payments and petitioner's services in itself shows that the importance of the benefits to the members far outweighed any generalized advantage to the industry as a whole.[6]

Finally, petitioner argues (Pet. 15-16) that the decision below is in conflict with *Crooks* v. *Kansas City Hay Dealers Assn.*, 37 F. 2d 83 (C.A. 8), affirming 28 F. 2d 909 (W.D. Mo.). In that case, the court held that an association of hay merchants, which performed weighing and other services for its members, was an exempt "business league" under Section 231 of the Revenue Act of 1924, 43 Stat. 282, a predecessor provision of Section 501(c)(6). While the facts are closely analogous to those involved here, the decision was rendered prior to the promulgation of the present version of the Treasury Regulations under Section 501(c)(6), which provide (Section 1.501 (c)(6)-1) that the organization's "activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the per-

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[6]Petitioner contends that it did not perform any services for its members on the ground that it only took over the furnishing of services formerly provided by the city. However, simply because an organization performs a function which has previously been performed exclusively by a municipal organization does not automatically render it exempt under Section 501(c)(6). Petitioner errs in claiming (Pet. 14) that its function is to perform services for the city, rather than its member-plumbers. Since plumbers remain liable for injuries caused by unrestored excavations, the economic burden of prolonged restoration is borne by petitioner's membership, rather than by the city or its residents.

formance of particular services for individual persons."[7] Indeed, the district court stated in *Kansas City Hay Dealers* that the term "business league" is "not defined in the act itself, nor has any judicial decision construing [it] as here used been called to my attention" (28 F. 2d at 910). Given the numerous subsequent appellate court decisions upholding the validity of the present regulations,[8] *Kansas City Hay Dealers* is of doubtful vitality.

CONCLUSION

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

SCOTT P. CRAMPTON,
Assistant Attorney General.

LEONARD J. HENZKE, JR.,
WESLEY J. FILER,
Attorneys.

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[7]The present form of the Regulation was first promulgated in 1929. See n. 5, *supra*. The prior version (Article 518 of Treasury Regulations 45) which was effective for the tax year in *Kansas City Hay Dealers* did not exclude an organization which performed services for individual persons from the definition of "business league". It defined a "business league" as "an association of persons having some common business interest, which limits its acitivities to work for such common interest and does not engage in a regular business of a kind ordinarily carried on for profit."

[8]See, *e.g.*, *Indiana Retail Hardware Assn.* v. *United States*, 366 F. 2d 998, 999 (Ct. Cl.); *Evanston-North Shore Board of Realtors* v. *United States*, 320 F. 2d 375 (Ct. Cl.), certiorari denied, 376 U.S. 931; *United States* v. *Oklahoma City Retailers Assn.*, 331 F. 2d 378 (C.A. 10); *Automotive Electric Assn.*,v. *Commissioner*, 168 F. 2d 366 (C.A. 6); *Apartment Operations Assn.*,v. *Commissioner*, 136 F. 2d 435 (C.A. 9); *Underwriters' Laboratories* v. *Commissioner*, 135 F. 2d 371 (C.A. 7), certiorari denied, 320 U.S. 756.